



0000156496

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

BOB STUMP
CHAIRMAN
GARY PIERCE
COMMISSIONER
BRENDA BURNS
COMMISSIONER
BOB BURNS
COMMISSIONER
SUSAN BITTER SMITH
COMMISSIONER

2014 OCT -6 P 3:00

AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission

DOCKETED

OCT 06 2014

DOCKETED BY

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS ANTHEM
WATER DISTRICT AND ITS SUN CITY
WATER DISTRICT.

Docket No. W-01303A-09-0343

ORIGINAL

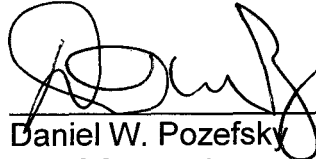
IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS
ANTHEM/AGUA FRIA WASTEWATER
DISTRICT, ITS SUN CITY WASTEWATER
DISTRICT AND ITS SUN CITY WEST
WASTEWATER DISTRICT.

Docket No. SW-01303A-09-0343

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the
Direct Testimony of Robert B. Mease, in the above-referenced matter.

1 RESPECTFULLY SUBMITTED this 6th day of October, 2014.

2
3 
4 Daniel W. Pozefsky
5 Chief Counsel
6
7

8 AN ORIGINAL AND THIRTEEN COPIES
9 of the foregoing filed this 6th day
10 of October, 2014 with:

11 Docket Control
12 Arizona Corporation Commission
13 1200 West Washington
14 Phoenix, Arizona 85007

15 COPIES of the foregoing hand delivered/
16 Mailed or emailed this 6th day of October, 2014 to:

17 Dwight Nodes
18 Administrative Law Judge
19 Arizona Corporation Commission
20 1200 West Washington
21 Phoenix, Arizona 85007

Lawrence V. Robertson, Jr.
P.O. Box 1448
Tubac, AZ 85646-1448
tubaclawyer@aol.com

22 Robin Mitchell, Attorney
23 Maureen Scott, Attorney
24 Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

W. R. Hansen
12302 West Swallow Drive
Sun City West, AZ 85375

Steve Olea, Director
Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Judith M. Dworkin
Roxann S. Gallagher
Sacks Tierney PA
4250 N. Drinkwater Blvd., 4th Floor
Scottsdale, Arizona 85251-3693
Judith.dworkin@sackstierney.com

1 Greg Patterson
916 W. Adams, Suite 3
2 Phoenix, AZ 85007
Gpatterson3@cox.net
3
4 Bradley J. Herrema
Robert Saperstein
Brownstein Hyatt Farber Schreck, LLP
5 21 East Carrillo Street
Santa Barbara, CA 93101
6 BHerrema@BHFS.com
RSaperstein@BHFS.com
7
8 Andrew M. Miller
Town of Paradise Valley
6401 E. Lincoln Drive
9 Paradise Valley, AZ 85253
amiller@paradisevalleyaz.gov
10
11 Michele L. Van Quathem
Ryley Carlock & Applewhite, P.A.
One N. Central Ave., Suite 1200
12 Phoenix, AZ 85004
mvanquathem@rcalaw.com
13
14 Larry D. Woods
15141 West Horseman Lane
Sun City West, AZ 85375
15
16 Joan S. Burke
Law Office of Joan S. Burke
1650 N. First Avenue
17 Phoenix, AZ 85003
Joan@jsburkelaw.com
18
19 Craig Marks
Craig A. Marks, PLC
10645 N. Tatum Blvd., Suite 200-676
20 Phoenix, Arizona 85028
Craig.marks@azbar.org
21
22
23
24

Gary Verburg, City Attorney
Daniel L. Brown, Assistant City Attorney
Office of the City Attorney
200 W. Washington Street, Suite 1300
Phoenix, AZ 85003-1611
Gary.verburg@phoenix.gov

Tammy Ryan
Andy Terrey
City of Phoenix
Water Services Department
200 W. Washington Street, 9th Floor
Phoenix, AZ 85003-1611

Frederick G. Botha
23024 N. Giovota Drive
Sun City West, AZ 85375

Norman D. James
Fennemore Craig, P.C.
3003 N. Central Avenue, Suite 2600
Phoenix, AZ 85012
njames@fclaw.com

Nicholas Mascia
1600 W. Broadway Rd, Suite 200
Tempe, Arizona 85282

Craig and Nancy Plummer
17174 W. Saguaro Lane
Surprise, Arizona 85388

Mike Albertson
6634 N. 176th Ave.
Waddell, Arizona 85355

Jim Weihman
Happy Trails Community Assoc.
17200 W. Bell Road
Surprise, Arizona 85374

Michael Bailey
City of Surprise
16000 N. Civic Center Plaza
Surprise, Arizona 85374

1 Kevin Chiariello
Greer Ranch South HOA
2 16074 W. Christy
Surprise, Arizona 85379
3
4 Brian O'Neal
21373 W. Brittle Bush Ln
Buckeye, Arizona 85396
5
6 Peggy Rahkola
The Arizona Traditions HOA
17221 N. Citrus
7 Surprise, Arizona 85374
8
9 Kenneth Hewitt
18729 N. Palermo Court
Surprise, Arizona 85387
10
11 Peter and Rochanee Corpus
8425 N. 181st Dr.
Waddell, Arizona 85355
12
13 Robert Metli
2398 E. Camelback Rd, Suite 240
Phoenix, Arizona 85016
rjmetli@mungerchadwick.com
14
15 Thomas Campbell
Michael Hallam
Lewis Roca Rothgerber, LLP
16 201 E. Washington St., Suite 1200
Phoenix, Arizona 85004
17 tcampbell@lrlaw.com
mhallam@lrlaw.com
18
19 Lynn Krupnik
Ekmark and Ekmark, LLC
6720 N. Scottsdale Rd, Suite 261
20 Scottsdale, Arizona 85253
21
22 George Turner
Russell Ranch Homeowners Assoc.
P.O. Box 12560
Glendale, Arizona 85318
23
24

Phillip Cook
10122 W. Signal Butte Circle
Sun City, Arizona 85373

Marshall Magruder
P.O. Box 1267
Tubac, Arizona 85646
mmagruder@earthlink.net

William Lipscomb
Kingswood Parke Community Assoc.
14976 W. Bottletree Ave.
Surprise, Arizona 85374

Jerome Ellison II
Cortessa Community Assoc.
P.O. Box 25466
Tempe, Arizona 85285-5466

Susan Harr
Summerfield at Litchfield Subdivision
HOA
13201 N. 35th Ave., Suite B-3
Phoenix, Arizona 85029

Dana Rosenbaum
Surprise Farms Community Assoc.
P.O. Box 25466
Tempe, Arizona 85285-5466

Timothy and Cindy Duffy
19997 N. Half Mood Drive
Surprise, Arizona 85374

Mike Smith
Sierra Montana HOA
c/o Rossmar and Graham
15396 N. 83rd Ave., Bldg B, Suite 101
Peoria, Arizona 85381

Garry Hayes
1702 E. Highland Ave., Suite 204
Phoenix, Arizona 85016
ghays@lawgddh.com

1	Jared Evenson Cross River Homeowners Assoc. 1600 W. Broadway Rd, Suite 200 Tempe, Arizona 85282	Albert Gervenack 14751 W. Buttonwood Drive Sun City, Arizona 85373
2		
3	Owen Dejanovich Clearwater Farms Three HOA P.O. Box 72 Waddell, Arizona 85355	Karen Proctor 11716 W. Villa Chula Court Sun City, Arizona 85375
4		
5		Robert McKenzie 41633 N. Panther Creek Trail Anthem, Arizona 85086
6	Stan Mucha Sun Village Community Assoc. 17300 N. Sun Valley Parkway Surprise, Arizona 85374	Francis Noe 11756 W. Daley Lane Sun City, Arizona 85373
7		
8	William and Erin Parr 18044 W. Georgia Ct. Litchfield Park, Arizona 85034	Douglas Edwards 13517 W. Sola Sun City West, Arizona 85375
9		
10	Sharon Wolcott 20117 N. Painted Cove Lane Surprise, Arizona 85387	Regina Shanney-Saborsky c/o Corte Bella Country Club HOA 22155 N. Mission Drive Sun City West, Arizona 85375
11		
12	Jeffrey Crockett Brownstein Hyatt Farber Schreck, LLP One E. Washington, Suite 2400 Phoenix, Arizona 85004 jcrockett@bhfs.com	Diane Smith 13234 W. Cabrillo Drive Sun City West, Arizona 85375
13		
14	Jim Oravetz Legacy Parc South HOA 1600 W. Broadway Rd, Suite 200 Tempe, Arizona 85282	Cynthia Campbell City of Phoenix 200 W. Washington, Suite 1300 Phoenix, Arizona 85003-1611
15		
16		
17		
18	Jan Garcia Sycamore Estates Parcel 13, Comm. Assn. 1600 W. Broadway Rd., Suite 200 Tempe, Arizona 85282	Jason Gellman Roshka DeWulf & Patten, PLC 400 E. Van Buren, Suite 800 Phoenix, Arizona 85004
19		
20		
21	Greg Eisert 10401 W. Coggins Drive Sun City, Arizona 85351	Chad Kaffer 3200 N. Central Ave., Suite 1200 Phoenix, Arizona 85012
22		
23		
24		

1 Scottsdale Citizens for Sustainable
Water
2 7322 E. Sierra Vista Drive
Scottsdale, Arizona 85250-4526
3
4
5

6 By Cheryl Frawlob
Cheryl Frawlob
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24

ARIZONA-AMERICAN WATER COMPANY

(now)

EPCOR WATER ARIZONA, INC.

DOCKET NO. SW-01303A-09-0343

DIRECT TESTIMONY

OF

ROBERT B. MEASE

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

OCTOBER 6, 2014

TABLE OF CONTENTS

EXECUTIVE SUMMARY	II
INTRODUCTION	1
WASTEWATER DISTRICTS INCLUDED IN CONSOLIDATION PROPOSAL.....	2
EPCOR'S CONSOLIDATION PROPOSAL.....	3
RATE DESIGN	8
RUCO'S ADDITIONAL CONCERNS	9
RUCO'S RECOMMENDATIONS	12
Attachment 1	Qualifications
Attachment 2	Consolidated Wastewater Rates Proposed
Attachment 3	Global Water Agreement
Attachment 4	City of Phoenix - Contract Audit

EXECUTIVE SUMMARY

On July 8, 2014, the Arizona Corporation Commission Staff ("Staff") issued a memorandum to the Arizona Corporation Commission ("Commission" or "ACC") discussing the numerous customer complaints and petitions that had been received by the Commission concerning EPCOR Water Arizona, Inc. ("EPCOR", "EWAZ", or "Company") Agua Fria District rates for water and wastewater services. On February 25, 2014, the Commission had received over 100 letters from ratepayers in the communities of Coldwater Ranch, Cross River, and Dos Rios asking the Commission to investigate their rates for both water and wastewater services. On March 7, 2014, the Commission received a letter that also included 2,320 signatures from Corte Bella Subdivision and Sun City West residents requesting an investigation and review of their water and wastewater rates. Finally, the third letter was received on April 9, 2014, that included approximately 1,100 signatures from the communities of Corte Bella, Cross River, Dos Rios and Coldwater Ranch requesting de-consolidation from the Agua Fria District and consolidate with the Sun City Water and Wastewater Districts. The purpose of Staff's memorandum was to provide an overview of the customer complaints and petitions as they relate to prior Commission decisions and to make recommendations to the Commission as to the process that could be used to address the issues raised by the customers of EPCOR.

Also attached to the Staff memorandum was a proposed order recommending that the Commission adopt in its ordering paragraphs all of Staff's recommendations and setting a procedural conference to address the processing of the matters discussed in Staff's memorandum.

On July 10, 2014, EPCOR responded to Staff's memorandum and requested that the Commission adopt the order proposed by Staff and approve an accounting order to record for accounting purposes the expenses related to this proceeding.

On July 30, 2014, Decision No. 74588 was issued requiring EPCOR to file by August 8, 2014, its response to address the issues as discussed in Staff's memorandum. EPCOR's response was to include:

- a. Response to the customer complaints and requests for relief.
- b. Response to Staff's opinion that the Commission's examination of these matters should commence with rate design matters related to wastewater rates.
- c. Discussion and analysis demonstrating the rate impacts of full consolidation of all districts, including a potential timeline for consolidation and whether phase in is warranted. Discussion and analysis should address when the circumstances in one district necessitate a substantive investment for new plant and/or infrastructure improvements, for only that district. This discussion should also address whether a rate case(s) would be warranted for consolidation of all districts.

- d. Discussion and analysis as to whether consolidation is warranted, when there is no nexus between districts that do not share contiguous service territorial borders whether conditions, urban or rural locations, farming factors and/or water supply needs.
- e. Discussion and analysis demonstrating the rate impacts of full deconsolidation of all districts and systems, including a potential timeline for deconsolidation and whether phase in is warranted. This discussion should address whether a rate case(s) would be warranted for deconsolidation.
- f. Discussion and analysis demonstrating the rate impacts of reversing the deconsolidation of Anthem from Agua Fria District, including a potential timeline for reversal and whether phase in is warranted. Discussion and analysis should include any and all implications to the settlement agreement In Docket Nos. W-01303A-09-0343 and SW-01301A-09-0343.
- g. Discussion of any EPCOR identified potential alternative options and the options' rate impacts of affected customers.
- h. Any recent calculation by EPCOR, which have previously identified potential alternative options, must be updated and must also add any new calculation if the next rate case moves forward as scheduled.

Decision No. 74588 required that on or before August 8, 2014, EPCOR shall file a response and present testimony to the Complaints addressing the issues as set forth in a. through h. above. It was also ordered that EPCOR is authorized to defer and record in its regulatory accounting records the expenses incurred related to this proceeding and the customer complaints described above for consideration in a future rate case.

On August 8, 2014, EPCOR filed its response and discussed the issues as required by Decision No. 74588. The Company came to the conclusion that full consolidation of its wastewater districts is the best long-term solution to address the concerns raised by its customers. EPCOR believes that full consolidation is the most equitable approach in the long term for establishing rates to recover reasonable expenses and capital expenditures and will reduce regulatory expenses and increase efficiencies. EPCOR in its response also came to the conclusion that this proceeding can move forward under A.R.S. §40-252 as it is revenue neutral and a full rate case is not required.

By a Procedural Order dated August 18, 2014, EPCOR was directed to file testimony on September 8, 2014, that intervenor direct testimony is due by October 6, 2014, and a hearing was set for November 12, 2014.

INTRODUCTION

Q. Please state your name, position, employer and address.

A. My name is Robert Mease and I'm Chief of Accounting and Rates for the Residential Utility Consumers Office. ("RUCO") My business address is 1110 W. Washington Street, Suite 220, Phoenix, AZ.

Q. Please state your educational background and qualifications in the utility regulation field.

A. Attachment 1, which is attached to this testimony, describes my educational background, work experience and regulatory matters in which I have participated. In summary, I joined RUCO in October of 2011. I graduated from Morris Harvey College in Charleston, WV and attended Kanawha Valley School of Graduate Studies. I am a Certified Public Accountant and currently licensed in the state of West Virginia. My years of work experience include serving as Vice President and Controller of Energy West, Inc. a public utility and Energy Company located in Great Falls, Montana. While with Energy West I had responsibility for all utility filings and participated in several rate case filings on behalf of the utility. As Energy West was a publicly traded company listed on the NASDAQ Exchange I also had responsibility for all filings with the Securities and Exchange Commission.

Q. Please state the purpose of your testimony.

A. The purpose of my testimony is to present RUCO's recommendations related to EPCOR's testimony filed on September 8, 2014, requesting to consolidate five wastewater districts into one consolidated system with a single unified rate.

WASTEWATER DISTRICTS INCLUDED IN CONSOLIDATION PROPOSAL

Q. Can you briefly describe the wastewater districts that EPCOR is proposing to consolidate?

A. The districts included in EPCOR's proposed consolidation plan include the Agua Fria Wastewater District, Anthem Wastewater District, Sun City Wastewater District, Sun City West Wastewater District and Mohave Wastewater District. Following is a brief description of each district.

Agua Fria Wastewater District -- The Agua Fria Wastewater District includes the communities of Corte Bella, Cross River, Rancho Silverado, Rio Sierra, Dos Rios and Rancho Cabrillo. These districts are referred to as the Northeast Region while the communities of Russell Ranch and Verrado are considered the southern portion of the Agua Fria District. As of July 31, 2014 there were 6,380 customers in the Agua Fria Wastewater District.

Anthem Wastewater District -- The Anthem Wastewater District provides wastewater service to the community of Anthem consisting of approximately 8,711 customers.

Sun City Wastewater District -- The Sun City Wastewater District is located in the northwest portion of Phoenix and provides wastewater service to Sun City, Youngstown and portions of Surprise and Peoria. There are approximately 22,149 customers in the Sun City District.

Sun City West Wastewater District -- The Sun City West Wastewater District is located in the northwest Phoenix area and provides wastewater services for the community of Sun City West. There are approximately 14,893 customers in the Sun City West District.

1 **Mohave Wastewater District** – The Mohave Wastewater District provides
2 wastewater services to a distinct service area of Mohave Valley and the Arizona
3 Gateway development. There are approximately 1,500 customers in the Mohave
4 Wastewater District.

5
6 **EPCOR'S CONSOLIDATION PROPOSAL**

7 **Q. Does EPCOR support full consolidation of its five existing wastewater**
8 **districts?**

9 A. Yes. As stated by the Company, EWAZ continues to support full consolidation of
10 its wastewater districts as the best long-term solution to address the concerns
11 raised by its customers, but more importantly as the most equitable approach in
12 the long term for establishing reasonable rates to recover the reasonable expenses
13 and capital expenditures that will ultimately impact every district at some point in
14 the future. In the long term, all wastewater customers will benefit from
15 predictable, uniform rate structures, reduced regulatory expenses and increased
16 efficiencies." (Page 11 Shawn Bradford's testimony)

17
18 **Q. Can you please identify the test year ending in each of the wastewater**
19 **districts most recent rate case orders?**

20 A. Yes. For the Agua Fria, Anthem, Sun City and Sun City West Wastewater Districts
21 the most recent test year was the period ending December 31, 2008, while the
22 Mohave Wastewater District had a test year ending December 31, 2007. (EWAZ
23 has a rate case application pending for its Mohave Wastewater District under
24 Docket No. SW-01303A-14-0010 with a test year ending June 30, 2013).

1 **Q. Do you consider 2008 and 2007 "stale test years?"**

2 A. Yes. Regardless of how you look at or analyze an increase or decrease in rates
3 you have to rely on information that is current. The total revenue requirements of
4 all the districts will change based on the changes in one or all of the components
5 that are used in determining revenue requirements.
6

7 **Q. Has EPCOR identified the primary benefits of full consolidation in its direct**
8 **testimony?**

9 A. Yes. Mr. Bradford in his testimony briefly discusses the benefits of full
10 consolidation. (See pg 13 of Mr. Bradford's testimony). Several of the benefits
11 identified in his testimony specifically discuss benefits that have a financial impact
12 on the Company and appear to be expense reduction benefits.
13

14 **Q. Can you identify what Mr. Bradford identifies as expense reduction**
15 **probabilities?**

16 A. Yes. Mr. Bradford states in his testimony that consolidation provides many
17 benefits to customers including the following specific financial benefits: (1) Improves
18 service affordability for customers; (2) Helps control cost of customer
19 accounting and billing systems; (3) Reduction in number of rate cases and
20 associated expenses; (4) Improves customer service efforts. There are other
21 benefits identified by Mr. Bradford but the four mentioned all could have a financial
22 impact on the Company and ultimately on its ratepayers.
23
24

1 **Q. Is it the Company's position that the proposed consolidation can proceed**
2 **under A.R.S. §40-252?**

3 A. Yes. As Ms. Hubbard explains on Pages 5 and 6 of her testimony "As a revenue-
4 neutral examination of rate design for its wastewater districts, the Company
5 continues to believe that a rate case is not required and that under the
6 Commission's current orders, a rate case could not proceed at this time."

7
8 **Q. Has the Commission approved the opening of the previous decision(s) under**
9 **A.R.S. §40-252?**

10 A. No. The Commission has not approved the opening of any of the previous
11 cases under the statute.

12
13 **Q. What is Ms. Hubbard referring to when stating that under the Commission's**
14 **current orders, a rate case could not proceed at this time?**

15 A. In Decision No. 72047, dated January 6, 2011, the Commission approved a rate
16 increase for the Anthem/Agua Fria Wastewater District. As part of that decision,
17 which resulted in part from a settlement agreement, the Commission left open the
18 docket to consider de-consolidation of the Anthem/Agua Fria Wastewater District.
19 Following an extensive hearing the Commission issued Decision No. 73227, dated
20 June 5, 2012, which ordered de-consolidation of the Anthem/Agua Fria wastewater
21 district into two separate districts. New rates based on the de-consolidation were
22 ordered to be phased-in over three years, with the final phase occurring in January
23 2015. As such, EWAZ's next rate case for these districts could not occur until after
24 June 30, 2015, which would be the earliest test year end date. The Company

believes that there is a requirement to wait until six months after the commencement of new rates and is a standard requirement that has been imposed by Commission Staff to improve the accuracy of reflecting the rate change in test year revenues.

Q. Do you agree with the Company's position that a rate case is not required in the current proposal to consolidate the five wastewater districts?

A. No. I believe that a rate case is absolutely necessary in this case. Even though the Company believes that a rate case is not necessary due to being revenue neutral, the proposed rate change(s) will affect the individual ratepayers in the five districts included in the consolidation proposal. EPCOR's current proposal reduces residential ratepayer's monthly rates in the Anthem, Agua Fria and Mohave Wastewater Districts while the proposed consolidated rate will increase the current rates in the Sun City and Sun City West Wastewater Districts. At a minimum, the Commission must determine the current fair value of the property devoted to the public service before it can increase rates. Fair value means the value of properties at the time of inquiry.

Q. Mr. Mease, didn't Decision No. 73227 require the Company to file cost of service studies at the time of submitting a consolidation proposal?

A. Yes. Decision No. 73227 stated the following: "In order to address the issue of deconsolidation/consolidation in the most expeditious and fair manner possible, we will require the Company to make the system-wide rate filing as ordered by Decision No. 72047 that includes all of the affected districts, including Sun City

1 Wastewater District, as soon as possible, so that all affected parties will receive
2 notice of, and will have a full opportunity to address, all the issues affecting the
3 Company's revenue requirement, and can make proposals either for or against
4 consolidation or deconsolidation for Commission consideration. The required
5 system-wide rate filing should include full cost of service studies and other
6 information supporting consolidation sufficient for all parties to make their own
7 reasoned proposals either for or against consolidation or deconsolidation,
8 consistent with sound ratemaking principles."
9

10 **Q. So what you're saying Mr. Mease, is that the Company has not complied with**
11 **Decision No. 73227?**

12 **A.** Yes. The Company has not complied with the Commissions previous decision.
13

14 **Q. Do you believe that the elements that are taken into consideration when**
15 **determining the revenue requirements in these five districts have changed**
16 **since the test years used to determine the current rates?**

17 **A.** Without question all of the primary elements used to determine revenue
18 requirements have changed. The total number of ratepayers since year 2008 has
19 increased by approximately 2,500; total wastewater system revenues have
20 increased by approximately \$7,000,000; each of the districts Utility Plant in
21 Service ("UPIS") has increased substantially; each of the districts expenses,
22 including income, payroll and property taxes, have changed since the current rates
23 were established; and finally, EPCOR's capital structure is not the same as that of
24

1 American-Arizona Water and the weighted average cost of capital will change as
2 will the resultant overall rate of return.

3
4 **RATE DESIGN**

5 **Q. Has the Company proposed a consolidated wastewater rate for the five**
6 **districts included in this filing?**

7 A. Yes. The company has proposed new rates based on consolidating the five
8 wastewater districts. As stated previously, EPCOR is using information to develop
9 a consolidated revenue requirement and determination of customer rates in four of
10 the five districts based on a test year ending in December 2008. Using data that is
11 six years old is contrary to good rate making principles, does not comply with the
12 fair value requirements and is not in the best interest of all ratepayers.

13 **Q. Can you please discuss the residential rate that the Company has calculated**
14 **as its consolidated rate for its residential ratepayers?**

15 A. EPCOR's proposal combines the revenue of the single unit residential customers of
16 all the wastewater districts and calculates a cost per single unit. The rate per single
17 residential unit was calculated to be \$34.30. The single unit rate was then applied
18 to multi-unit residential customers to keep the rate consistent with the present rate
19 design. (See Attachment 2 for rate comparisons)

1 **Q. Was a calculation also made to recognize that residential customers may**
2 **have different meter sizes?**

3 A. No. There is only one residential rate per month proposed by the Company. The
4 rate of \$34.30 applies to each residential unit and there is no distinction between
5 size of meter and there are no volumetric charges based on water usage. In other
6 words, a flat charge has been proposed for each residential ratepayer that equates
7 to \$34.30. This is a major departure from traditional rate design that encourages
8 conservation and needs to be vetted in a full rate case.

9
10 **Q. What has the Company proposed for the commercial ratepayers?**

11 A. It appears based on schedules filed that commercial ratepayers will pay different
12 rates depending on the district. For example, in the Agua Fria and Anthem Districts
13 a commercial rate of \$81.59 has been proposed for all meter sizes up to usage of
14 15,000 gallons. In Sun City and Sun City West the flat rate of \$81.59 remains the
15 same but usage has increased up to a 40,000 gallons. The Mohave Wastewater
16 District has a different proposed rate schedule due to its uniqueness.

17
18 **RUCO's ADDITIONAL CONCERNS**

19 **Q. Has anything else come to RUCO's attention that would warrant the filing of a**
20 **rate case prior to consolidation of the wastewater districts included in**
21 **this current proposal?**

22 A. Yes. On September 30, 2014, the City of Phoenix ("Phoenix") filed to intervene in
23 the docket for the limited purpose of challenging the jurisdiction of the Arizona
24 Corporation to set a "rate applicable to Phoenix as a rate payer of EPCOR in either

1 Anthem Water or Wastewater Districts. Phoenix identifies many points to support
2 its request for intervention, however, the most important of the items is number 13,
3 as shown on page 6 of its filing. It states as follows: "In the current matter before
4 the Commission, EPCOR is again attempting to apply a commodity rate to the
5 contractual price Phoenix pays for contractual water and wastewater services.
6 Including Phoenix in the mix as a "ratepayer" not only prejudices Phoenix through
7 EPCOR's continued effort to apply regulatory rates to Phoenix, but also the
8 other rate payers of EPCOR whose rates are based on a flawed consideration of
9 rate base that does not comply with prior Commission decisions or Commission
10 administrative rules."

11
12 **Q. Does RUCO have additional information that supports the City of Phoenix's**
13 **testimony?**

14 **A.** Yes. A copy of the Internal Audit performed by the City is included as Attachment 4.
15 The Contract Audit, dated June 30, 2014, was conducted by the City Auditor's
16 Department and indicates that the City has been overcharged by as much as \$2.8
17 million.

18
19 **Q. Based on the issue raised by the City of Phoenix is RUCO concerned that the**
20 **revenues generated by the contract with the City of Phoenix may not have**
21 **been accounted for correctly in the last rate case filing or in the current**
22 **consolidation proposal?**

23 **A.** Yes. This is a great concern to RUCO. According to the filing Phoenix believes that
24 EPCOR has failed to comply with previous decisions as well as this current filing.

1 RUCO's initial review indicates that the revenues generated from Phoenix are
2 included as revenues in this current filing and the rate as shown in the schedules
3 provided has increased which may be contrary the Company's existing contract with
4 Phoenix.

5
6 **Q. What is RUCO's position to resolve this potential error?**

7 A. I believe that this just further strengthens our position that a full rate case is
8 necessary prior to adjusting rates for consolidation. As stated, the effect of
9 including Phoenix is distorting rate base that effects rates charged to all
10 ratepayers.

11
12 **Q. Are there other issues that you would like to address?**

13 A. Yes. RUCO has become aware that EPCOR entered into an agreement with Global
14 Water Resources Corp. to sell certain Global Water interests within the City of
15 Glendale. EPCOR will purchase agreements that allow for the provision of
16 wastewater and recycled water services to a 7,000 acre area known as the Loop
17 303 Corridor. Global Water will receive total proceeds of \$4.1 million over a
18 multi-year period, including \$2.6 million that was to be realized during 2013. (See
19 Attachment 3) Also, on December 17, 2013, ECPOR filed under Docket No. SW-
20 01303A-13-0446 an Application for an Extension of Certificate of Convenience and
21 Necessity. The purpose of this filing was to request an authorization for the
22 extension of its existing Agua Fria Wastewater District to provide sewer utility
23 service in certain defined portions of Maricopa County. This filing is also related to
24

1 the Loop 303 Corridor and the Company included in its filing that they expect to
2 spend \$36,500,000 over the next five years in plant additions.

3
4 **Q. Has EPCOR included in this current filing requesting consolidation how this**
5 **future expansion is going to affect current consolidation of rates?**

6 A. No.

7
8 **Q. Has the Company addressed in its application how they will address major**
9 **projects such as this in future expansion of existing districts?**

10 A. No.

11
12 **Q. Has the Company addressed how they will address future potential purchases**
13 **of existing wastewater companies?**

14 A. No.

15
16 **RUCO's RECOMMENDATIONS**

17 **Q. Can you please explain RUCO's recommendations related to consolidating**
18 **the five wastewater districts that the Company has proposed?**

19 A. Yes. RUCO's recommendations are as follows:

20 (1) RUCO's first recommendation is that the Company file a rate case and include
21 all five wastewater districts that are included in the Company's consolidation
22 proposal. RUCO believes that the revenue requirements and resultant rates that
23 were approved in the prior decisions affecting the Sun City, Sun City West, Aqua
24 Fria and Anthem Wastewater Districts using a test year ending December 31, 2008,

1 is not relevant today. For example, the total number of customers has increased
2 substantially since the last rate case, the rate base has changed significantly since
3 the prior case, all districts are under new ownership since the last case and the
4 capital structure of EPCOR is not the same as the previous owner. In short, the
5 details that led to determining revenue requirements in the 2008 case are old or
6 "stale", not relevant today, and to increase or decrease rates based on old data is
7 not in the best interest of all residential ratepayers affected by the proposed
8 change. As part of the rate case filing that RUCO is recommending, the Company
9 should determine if phased in rates are warranted.

10
11 In addition to RUCO's belief that all elements affecting revenue requirements have
12 changed, the prior Decision No. 73227 required a rate case be submitted with full
13 cost of service studies prior to requesting full consolidation or deconsolidation.
14 Moreover, the Mohave Wastewater District was not part of that last rate case so in
15 addition to the stale test year, consolidation under this format would involve districts
16 with different test years which is not only legally questionable, but pretty much
17 guaranteed to lead to unfair and unreasonable rates.

18
19 (2) RUCO's second recommendation is to remove the Mohave Wastewater District
20 from the current EPCOR rate application and include it in the rate case that RUCO
21 is proposing in our first recommendation. The Mohave Wastewater District is
22 currently included in EPCOR's current rate application under Docket No. WS-
23 01301A-14-0010 and should be withdrawn and included in the consolidated rate
24 case application.

1 (3) RUCO's third recommendation is to freeze the current rates in the Agua Fria and
2 Anthem Districts that will increase the Aqua Fria's rates by \$15.70 per month
3 and decrease Anthem's rates by \$6.18 per month. The rate adjustment was
4 previously approved by the Commission in Decision No. 73227, and will take effect
5 on January 1, 2015.

6
7 (4) RUCO's final recommendation is to require the Company to prepare a Plan of
8 Administration defining how future expansions and potential acquisitions will be
9 incorporated into the consolidated rate structure. The Company has major
10 expansion plans along the Loop 303 Corridor anticipating major capital
11 expenditures in the Agua Fria District. Major expansions such as this can, and will,
12 have a significant effect on all ratepayers. This project is in the planning stages now
13 and should be addressed in this filing.

14
15 **Q. Does this conclude your testimony in this filing?**

16 **A. Yes.**
17
18
19
20
21
22
23
24

ATTACHMENT 1

ROBERT B. MEASE, CPA **Education and Professional Qualifications**

EDUCATION

Bachelors Degree Business Administration / Accounting - Morris Harvey College.

Attended West Virginia School of Graduate Studies and studied Accounting and Public Administration

Attended numerous courses and seminars for Continuing Professional Educational purposes.

WORK EXPERIENCE

Controller

Knives of Alaska, Inc., Diamond Blade, LLC, and Alaska Expedition Company.

Financial Manager / CFO

All Saints Camp & Conference Center

Energy West, Inc.

Vice President, Controller

- Led team that succeeded in obtaining a \$1.5 million annual utility rate increase
- Coached accountants for proper communication techniques with Public Service Commission, supervised 9 professional accountants
- Developed financial models used to negotiate an \$18 million credit line
- Responsible for monthly, quarterly and annual financial statements for internal and external purposes, SEC filings on a quarterly and annual basis, quarterly presentations to Board of Directors and shareholders during annual meetings, coordinated annual audit
- Communication with senior management team, supervised accounting staff and resolved all accounting issues, reviewed expenditures related to capital projects
- Monitored natural gas prices and worked with senior buyers to ensure optimal price obtained

Junkermier, Clark, Campanella, Stevens

Consulting Staff

- Established a consulting practice that generated approximately \$160k the first year of existence
- Prepared business plan and projections for inclusion in clients financing documents
- Prepared written reports related to consulting engagements performed
- Developed models used in financing documents and made available for other personnel to use
- Performed Profit Enhancement engagements
- Participated during audit of large manufacturing client for two reporting years

Prior to 1999, held various positions: TMC Sales, Inc. as **Vice President / Controller**, with American Agri-Technology Corporation as **Vice President / CFO** and with Union Carbide Corporation as **Accounting Manager**. (Union Carbide was a multi-national Fortune 500 Company that was purchased by Dow Chemical)

PROFESSIONAL AFFILIATIONS

Past Member - Institute of Management Accountants

Member - American Institute of CPA's

Member - Society of Utility and Regulatory Financial Analysts

Past Member - WV Society of CPA's and Montana Society of CPA's

RESUME OF RATE CASE AND REGULATORY PARTICIPATION WITH RUCO

<u>Utility Company</u>	<u>Docket No.</u>
Arizona Water Company (Eastern Group)	W-01445A-11-0310
Pima Utility Company	W-02199A-11-0329 et al.
Tucson Electric Power Company	E-01933A-12-0291
Arizona Water Company (Northern Group)	W-01445A-12-0348
UNS Electric	E-04204A-12-0504
Global Water	W-01212A-12-0309 et al.
LPSCO	SW-01428A-13-0042 et al.
Johnson Utilities	WS-02987A-13-0477
APS	E-01345A-11-0224
Utility Source, LLC	WS-04235A-13-0331
EPCOR Water Arizona, Inc.	WS-01303A-14-0010

ATTACHMENT 2 -- EPCOR'S RESIDENTIAL RATES

<u>SYSTEM</u>	<u>CURRENT RATES</u> <u>TOTAL</u>	<u>RECOMMENDED</u> Note (4) <u>RATE</u>	<u>INC (DEC)</u>	<u>PERCENT</u>
Agua Fria - Note (1) (3)	\$ 121.91	\$ 34.30	(\$ 87.61)	(71.86 %)
Anthem - Note (2) (3)	\$ 56.26	\$ 34.30	(\$ 21.95)	(39.02 %)
Mohave WWater	\$ 82.79	\$ 34.30	(\$ 48.49)	(58.57 %)
Sun City	\$ 18.11	\$ 34.30	\$ 16.19	89.40 %
Sun City West	\$ 30.96	\$ 34.30	\$ 3.34	10.79 %

Note: (1) Agua Fria and Anthem – Current rates reflect rates scheduled to go into effect on January 1, 2015.

Note: (2) Mohave Wastewater -- Current rates reflect pending increase in rates as filed in Docket No. WS-01303A-14-0010

Note: (3) Current Rates based on average usage of 7,000 gallons per month

Note: (4) Recommended rates based on Flat Charge monthly

**PRESS RELEASE***For Immediate Release***GLOBAL WATER TO SELL CERTAIN AGREEMENTS THAT ALLOW FOR
FUTURE UTILITY SERVICES IN THE CITY OF GLENDALE**

PHOENIX, AZ – September 25, 2013 – GWR Global Water Resources Corp. (TSX:GWR) ("GWRC") today announced that Global Water Resources, Inc. ("Global Water") has entered into an Agreement with EPCOR Water Arizona Inc. ("EPCOR") to sell certain Global Water interests within the City of Glendale ("City"). EPCOR will purchase agreements that allow for the provision of wastewater and recycled water services to a 7,000 acre area known as the Loop 303 Corridor ("303 Corridor"). Global Water will receive total proceeds of \$4.1 million over a multi-year period, including \$2.6 million that will be realized during 2013.

Global Water entered into agreements with numerous landowners and the City in late 2012 to create a regional wastewater and recycled water solution for future development of the 303 Corridor. Since that time, Global Water has moved rapidly towards creating a new utility subsidiary (the "303 Utilities Company"), and had completed preliminary work related to master-planning and permitting requirements. With the Agreement, EPCOR will now take ownership of all completed work products and will assume Global Water's obligations, rights, and interest in providing service to the 303 Corridor.

"This agreement is another step forward in our strategic plan to surface near term value for our shareholders," said Trevor Hill, Chairman and CEO of Global Water. "After discussing this opportunity with all parties involved, it made sense to have EPCOR step into these contracts as they already provide water services for most of the area and can also fulfill the wastewater and recycled water obligations to the landowners and the City. The sale will allow Global Water to capitalize immediately on our many years of work in developing the basis of the regional wastewater solution."

While the 303 Utilities Company was part of Global Water's long term growth strategy, the opportunity to sell the related contracts is in-line with its current objectives including the liquidation of non-core assets where appropriate as to continuously improve cash flows for Global Water and its investors.

"EPCOR is committed to expanding on our utilities in the West Valley and to be the regional, integrated wastewater and water provider for the western area of Glendale," said Joe Gysel, President of EPCOR Water (USA) Inc., the Phoenix-based parent company of EPCOR Water Arizona Inc. "We look forward to working in partnership with the City of Glendale and private landowners as the development of the Loop 303 Corridor and the West Valley continues."

About GWR Global Water Resources Corp ("GWRC")

GWRC was incorporated in British Columbia to acquire shares of U.S. based Global Water Resources, Inc. ("Global Water") and to actively participate in the management, business and operations of Global Water through its representation on the board of directors of Global Water and its shared management of Global Water. GWRC currently holds 48.1% of the outstanding shares of Global Water.

About Global Water

Global Water is a pure-play, high-growth water resources company located in Phoenix, Arizona, that owns and operates regulated water, wastewater, and recycled water utilities in the metropolitan Phoenix area.



For more information, please contact:

Ross Marshall

Investor Relations

Tel: 416-815-0700 ext. 238

Email: rmarshall@tmxequicom.com

www.gwresources.com

www.gwfathom.com

ATTACHMENT 4



City of Phoenix

June 30, 2014

Kathryn Sorensen
Water Services Director

SUBJECT: CONTRACT AUDIT - EPCOR

This is our final report. A summary of the work is presented in the Executive Summary, which immediately follows. The department's responses to our recommendations immediately follow the Executive Summary.

Sincerely,

A handwritten signature in cursive script that reads "Bill Greene".

Bill Greene
City Auditor

1140049f

Audit Team: Barbara Coppage, Deputy City Auditor
Shaelin Charania, Internal Auditor
Wendy Simeon, Internal Auditor

Attachment

cc: City Manager's Office
Ed Zuercher, City Manager
Milton Dohoney, Assistant City Manager
Rick Naimark, Deputy City Manager

Water Services Department
Sylvia Arenas, Administrative Assistant II (Audit Liaison)
Joe Giudice, Acting Assistant Water Services Director



City of Phoenix

Mission Statement

"To improve the quality of life in Phoenix
through efficient delivery of outstanding public services."

Contract Audit - EPCOR

Water Department

June 30, 2014

Project Team:

Barbara Coppage, Deputy City Auditor
Shaelin Charania, Internal Auditor
Wendy Simeon, Internal Auditor

Project Number: 1140049

City Auditor Department

Bill Greene
City Auditor

**City of Phoenix
City Auditor Department
17 S. 2nd Avenue, Suite 200
Phoenix, AZ 85003**

This report can be made available in alternate format upon request.
More information: 602-262-6641 (voice) or 602-534-5500 (TTY)

Contract Audit - EPCOR

Executive Summary

PURPOSE

We reviewed water wheeling and wastewater service billings for the Phoenix West Anthem area from May 2008 to December 2013 to determine if amounts billed were accurate and in accordance with contract guidelines. We also reviewed the Water Department's (Water) monitoring processes to ensure compliance with contract terms.

BACKGROUND

The City of Phoenix (City) currently does not have the infrastructure to provide water and wastewater services in the West Anthem area and relies on contracted services to provide water wheeling and wastewater services. In September 2000, Water entered into a multi-term agreement with TreatCo to provide water and wastewater services through an interconnect from the east side of I-17 to the Phoenix (West) Anthem area. Each service in the agreement has a separate expiration date. Since the contract began, ownership has changed twice. From 2008 to 2011, Arizona American Water (AAW) was the vendor and the current vendor is EPCOR. Although ownership of the company has changed, the original contract (#93040) is still in place.

From May 2008 through December 2011, the City paid AAW \$3,727,000 for over 877,000,000 gallons of water wheeling and wastewater services provided to Phoenix West Anthem. From January 2012 through December 2013, the City of Phoenix paid EPCOR \$2,376,000 for over 410,000,000 gallons of water wheeling and wastewater services provided to Phoenix Anthem.

RESULTS IN BRIEF

Water's contract monitoring did not ensure the amounts paid were accurate and in accordance with contract guidelines. As a result, Water potentially overpaid AAW/EPCOR for water loss charges by as much as \$44,828 and \$5,377 for taxes.

The contract stated "Meters will be read jointly by both parties on a monthly basis for billing purposes". We noted that joint meter reads were not performed nor were the meters maintained or calibrated as required by the contract and necessary to ensure the accuracy of the invoices. Water's review was limited to mathematical accuracy and reasonableness of gallons billed. However, Water did not have thresholds related to when a variance would be considered unreasonable or procedures for how to interpret the data. As a result of our audit, Water began performing joint meter reads and created a spreadsheet to document the date and meter read. The spreadsheet also calculated the gallons pulled, which agreed to EPCOR's invoice.

We also noted that Water did not monitor the basis for how water loss charges were calculated by EPCOR. The contract states that water loss charges will be made in accordance with the percentage of losses reported to the Arizona Department of Water Resources (ADWR) or other reasonable methodology approved in writing and the percentage of losses will not exceed ten percent (10%). We noted that EPCOR charged the maximum rate of 10% without

support for water losses related to the wheeling service. EPCOR stated they reported distribution system water loss percentages to the Arizona Corporation Commission (ACC), not ADWR, and they would issue a refund of approximately \$6,926. Using the same methodology, we estimate AAW and EPCOR overcharged Water by \$26,302. However, as Water did not approve the alternate methodology possible water loss overpayment could be as high as \$44,828.

Although the City was exempt from taxes on wholesale water purchases under City Code and Arizona Revised Statutes, Water paid over \$5,377 for taxes.

Since June 2008, AAW and EPCOR implemented increases to water wheeling and wastewater services rates without providing support for the higher rates. Water has worked with the Law Department since 2011 to determine if the rate changes were authorized under the contract. This unresolved disputed amount may be up to \$2,730,286.

We determined both AAW and EPCOR charged fees higher than those stated in the contract. The contract stated "AAW/EPCOR will have the right to request changes in such rate from time to time, but those requested changes must be based on changes in the actual costs paid or incurred by AAW/EPCOR with respect to providing the services pursuant to this article." Since 2011, Water (with the assistance of the Law Department) made several attempts to obtain information from AAW and EPCOR to support the rate increases and in April 2011, Water began stamping invoices "Paid Under Protest" on all payments.

Since May 2008, the City paid AAW \$1,428,987 and EPCOR \$1,301,299 above the original terms of the contract. Until this issue is resolved, the City will continue to have an unresolved disputed amount of approximately \$357,000 per year for water and wastewater services above the original rates set in the contract.

Based on internal reports prepared by Water, we estimated the City may realize \$270,000 of annual savings by building infrastructure to deliver potable water to West Anthem and paying for wastewater thru a metered rate. A cost of service study will be required to determine the actual value of the potential savings.

The contract states "The initial wholesale wastewater rate will be \$2.32 per one thousand gallons of potable water delivered by TreatCo to Phoenix. If and when the potable water service is discontinued, the rate pursuant to this section will be converted to a metered rate." We calculated potential wastewater costs savings using an estimated metered rate instead of per one thousand gallon of water consumption.

Based on our analysis, we estimated the City could have saved up to \$2.5 million if wastewater charges had been metered. Further, based on the ACC approved wastewater rates for 2014 and 2015, the City will pay approximately \$540,000 above the estimated metered charge.

We reviewed an internal report prepared by Water which stated it would cost approximately \$2.7 million to connect the West Anthem area to the City's water system. We did not review the accuracy of the wastewater percentage or the capital costs of infrastructure in these reports. However, we noted that the cost savings from 2008 through 2013 (\$2.5 million) would have paid for most of the infrastructure costs (\$2.7 million) necessary for metered wastewater.

The following section includes our recommendations and the department's response.

Department Responses to Recommendations

NOTE: This table will be completed after the responses are received by the department. The complete table will appear in the final audit report.

Rec. 1.1: Water work with EPCOR to correct the read dates on the invoice, continue to do monthly joint meter reads, and use the information to verify the accuracy of EPCOR's invoice.	
Response: As of May 2014, the read dates on EPCOR invoices have been corrected. Water is continuing bi-monthly joint meter reads to verify accuracy of billed volume on EPCOR's invoices.	Target Date: Completed
Rec. 1.2: Water assign responsible staff to review the contract, develop monitoring procedures and variance thresholds to ensure contract terms and variances are monitored and corrective action is taken as needed.	
Response: A. Water will develop written procedures for managing all aspects of the EPCOR contract. B. A contract manager has been assigned to ensure the procedures are being followed.	Target Date: 10/31/14
Rec. 1.3: Water ensure meters A and Z are maintained and calibrated as required and are inspected/tested annually to ensure accuracy.	
Response: Procedures pertaining to annual maintenance, testing, and calibration of meters A and Z will be included in the WACMD.	Target Date: 10/31/14
Rec. 2.1: Water evaluate the costs of continuing to pay under protest versus the pursuit of other alternatives.	
Response: Water and Law Department will evaluate the "pay under protest policy."	Target Date: 1/31/15
Rec. 3.1: Water and EPCOR establish, in writing, a reasonable methodology to calculate water losses related to the wheeling service and assign staff to monitor the accuracy of water loss charges. Water work with Law to determine if the overpayment to AAW can be recovered and collect the monies from EPCOR related to water loss overpayments.	
Response: A. Water will establish a formalized written process for determining water losses for the purpose of billing in accordance with the Agreement. Procedures for monitoring EPCOR's calculation of losses will be developed.	Target Date: 1/31/15

<p>B. Water and EPCOR have begun discussions on the overpayment related to water loss calculations by EPCOR. Water and Law will review the AAW overcharges to determine if they can be collected from EPCOR.</p>	
<p>Rec. 3.2: Water develop a formal water control program and assign responsible staff to track/monitor water losses and methods to reduce non-revenue consumption.</p>	
<p>Response:</p> <p>A. Water has assigned responsible staff to track/monitor water losses.</p> <p>B. Water will develop a formal water control program to track/monitor water losses and methods to reduce non-revenue consumption.</p>	<p><u>Target Date:</u> 12/31/14</p>
<p>Rec. 4.1: Water work with Law to determine if the overpayment to AAW can be recovered and with Law's assistance recover \$1,214 from EPCOR for inappropriate State and County taxes paid.</p>	
<p>Response:</p> <p>A. Water and Law will evaluate and determine if the overpayment to AAW can be recovered.</p> <p>B. Water and Law will work with EPCOR to recover \$1,214 from EPCOR for inappropriate State and County taxes paid.</p>	<p><u>Target Date:</u> 10/31/14</p>
<p>Rec. 5.1: Water review the infrastructure costs to connect West Anthem to the City's water system and analyze the costs and benefits of this capital project compared to other proposed projects.</p>	
<p>Response: Water has reviewed the infrastructure costs to connect West Anthem to the City's water and wastewater systems. The department's executive CIP charter team has approved the wastewater sewer connection project and the water service connection project. Design will start in FY14-15 and construction is planned within the department's five-year CIP program.</p>	<p><u>Target Date:</u> Completed</p>

Table of Contents

Executive Summary	1
Department Responses to Recommendations	3
Table of Contents	5
Scope, Methods & Standards	6
Detailed Observations by Major Scope Areas:	
1 – Accuracy of Invoices and Meters	7
2 – Water and Wastewater Rates	11
3 – Water Loss	13
4 – Taxes	16
5 – Cost Savings Opportunity	18

Scope, Methods & Standards

Scope

We reviewed Water's monitoring processes related to Arizona American Water (AAW) and EPCOR invoices from May 2008 through December 2013.

Methods

The following methods were used to complete this audit:

- Rates billed agreed to the contract
- Amounts invoiced agreed to meter readings
- Water loss percentages were assessed in accordance with the contract
- Water meters were properly maintained and calibrated to ensure accurate readings

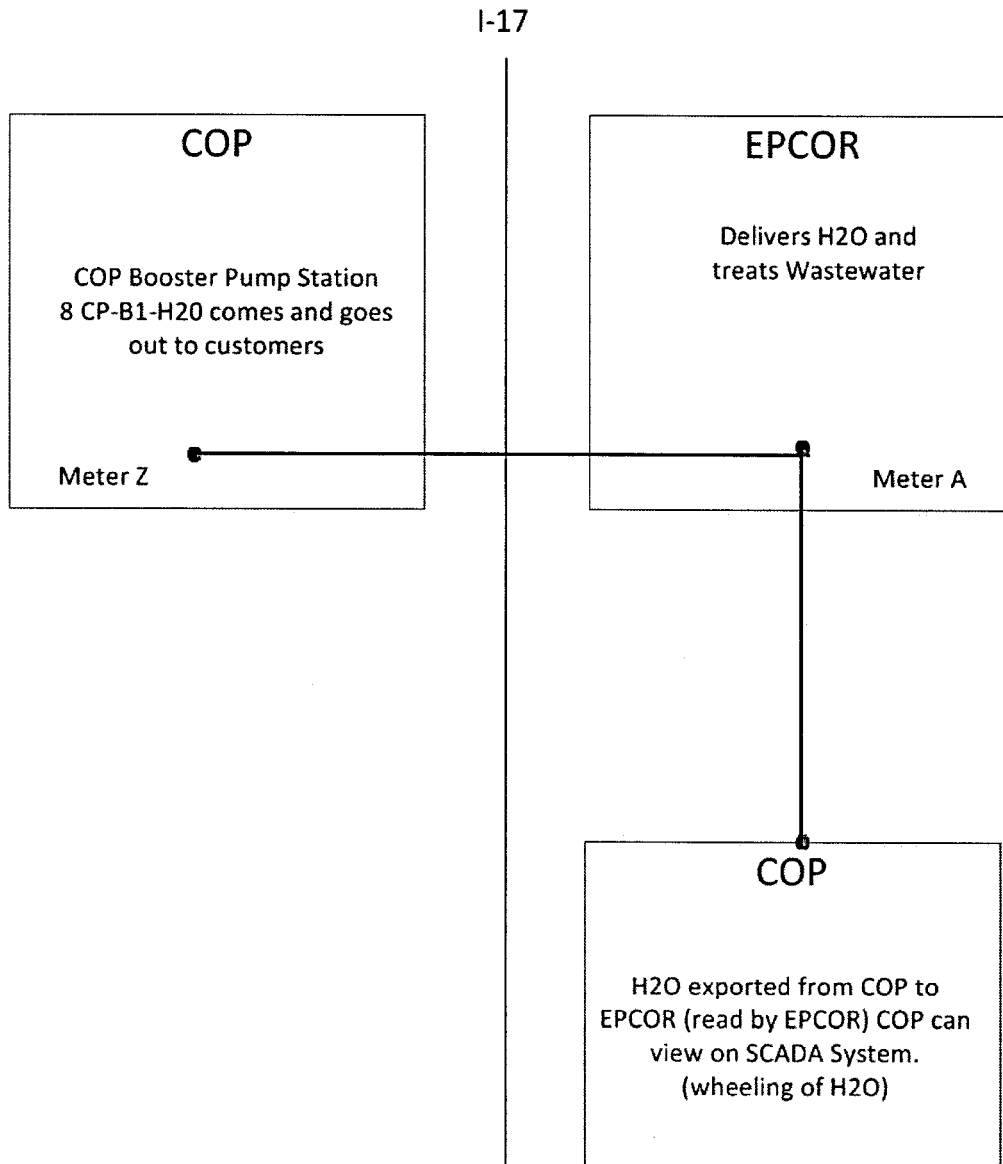
Standards

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

1 – Accuracy of Invoices and Meters

BACKGROUND

The City provided potable water to EPCOR's West Campus (meter A), EPCOR wheeled potable water to the City's West Anthem distribution point (meter Z). The water provided and delivered was measured per thousand gallons at EPCOR's meter A and the City's meter Z. See graph below for this process:



To ensure accuracy of the bills, the contract required "meters (meters A and Z) be read jointly by both parties on a monthly basis for billing purposes." In addition, to provide adequate contract monitoring and ensure reliability of the meters, the contract also stated "Phoenix will be responsible for calibration and preventative maintenance of all

metering, instrumentation and telemetry equipment required by EPCOR for delivery of the potable water at the EPCOR-to-Phoenix delivery point (meter Z). All necessary calibration will be performed by an independent contractor every year at Phoenix's cost." The contract contained a similar clause that required EPCOR to perform calibration and maintenance for the equipment at the Phoenix-to-EPCOR delivery point (meter A).

Water also used the SCADA system to monitor and control remote facilities (booster stations, wells, reservoirs, etc.) and collect data. Data collected from remote facilities included system operating parameters like pressure, flow rate (i.e. gallons), and reservoir storage level.

To determine compliance with contract terms, we requested calibration and maintenance records for meters A and Z and supporting documentation related to joint meter reads.

RESULTS

Water did not perform joint meter reads as required by the contract and instead compared the gallons billed by EPCOR to gallons measured by the SCADA system without written procedures or variance thresholds to determine reasonableness.

The contract stated "Meters will be read jointly by both parties on a monthly basis for billing purposes". In our 2006 audit of Arizona American Water (AAW), EPCOR's predecessor, we recommended "Water work towards obtaining electronic meter readings to allow joint meter reads as required by the contract". Based on discussions with staff, Water did not implement this recommendation. Instead Water staff developed a process to compare the gallons billed on the invoices to the SCADA system; however, Water's review was limited to mathematical accuracy and reasonableness of gallons billed. However, Water did not have thresholds related to when a variance would be considered unreasonable or procedures for how to interpret the data.

We selected three invoices for testing and the associated support. Based on our review, EPCOR's invoices were consistently higher compared to supporting documentation (i.e., SCADA report). Water staff stated this was due to timing differences. To determine the significance of the variance and verify if it was related to timing differences, we obtained two years of SCADA data and compared it to the gallons billed by EPCOR. We determined EPCOR's billed gallons were 27.1 million higher than SCADA gallons, or a 7% variance.

We determined the EPCOR invoice meter read dates did not reflect the actual meter read dates. The meter was actually read on the first of the month, not mid-month as stated on the invoice. This led to inaccurate comparisons; therefore, we summarized the SCADA data by month and noted the EPCOR to SCADA variance dropped from 27.1 million to 6.8 million gallons, or from a 7% to 2% variance.

As a result of our audit and variance analysis, Water began performing joint meters reads and created a spreadsheet to document the date and meter read. The spreadsheet also calculated the gallons pulled, which agreed to EPCOR's invoice gallons billed, but the "Meter Read" date did not agree. Water requested EPCOR correct its invoices to reflect the actual meter read date.

An effective invoice review process is dependent on the accuracy of the meters, which is determined by calibration testing. Water did not ensure meters A and Z were calibrated or maintained, as required by the contract; however, during the audit both meters passed calibration tests.

As noted above, the invoice review process was dependent on the accuracy of the meters. The contract required Phoenix to perform calibration and maintenance for the equipment at the EPCOR-to-Phoenix delivery point (meter Z) and that EPCOR perform calibration and maintenance for the equipment at the Phoenix-to-EPCOR delivery point (meter A). We requested calibration and maintenance records, but determined staff were not familiar with the contract terms and therefore, did not know the meters should have been maintained and calibrated, or that reports for meter A should have been obtained and reviewed.

At our request, Water obtained the meter Z manufacturer's standard operating procedures (SOP) for calibration and maintenance of the meter. The SOP stated "re-calibration and maintenance interval for each device is the responsibility of the end user and must be established within the scope of application, its required accuracy, and its criticality to the process and any legislative constraints imposed on the duty." The SOP also stated "if the device is in hostile ambient conditions, calibration should occur every 1-4 years." Water did not perform maintenance or calibration as required by the contract or manufacturer's SOP, nor did Water have procedures in place to ensure the accuracy of the meter.

We also determined meter Z was replaced in 2012 because the original meter was too large to accurately register the typical flow coming into West Anthem. An oversized meter can lead to more gallons being billed than were actually used. As the meter was replaced, we did not determine the financial loss related to the meter being too large.

During the audit, Water staff challenged (tested) meter Z, the results showed the meter was within 0.2% (e.g., the meter was considered accurate). Water also scheduled the manufacturer to perform an initial calibration of the meter in late April; the meter passed. In addition, Water prepared a written preventative maintenance schedule to calibrate the EPCOR-to-Phoenix Interconnect Meter on an annual basis.

We also determined Water had not obtained verification from EPCOR that meter A was maintained and calibrated. As a result of this audit, Water obtained the 2012 and 2013 meter A reports from EPCOR, which stated the meter passed the calibration test for both years.

RECOMMENDATIONS

- 1.1 Water work with EPCOR to correct the read dates on the invoice, continue to do monthly joint meter reads, and use the information to verify the accuracy of EPCOR's invoice.
- 1.2 Water assign responsible staff to review the contract, develop monitoring procedures and variance thresholds to ensure contract terms and variances are monitored and corrective action is taken as needed.
- 1.3 Water ensure meters A and Z are maintained and calibrated as required and are inspected/tested annually to ensure accuracy.

2 – Water and Wastewater Rates

BACKGROUND

Water

The contract states that “the wheeling Potable Water delivery rate will be \$0.30 per one thousand gallons of Potable Water delivered.” The contract also stated that “The Parties acknowledge that the rate described....may be altered from time to time by the Arizona Corporation Commission with or without the consent of Arizona American Water (AAW)/EPCOR. AAW/EPCOR will have the right to request changes in such rate from time to time, but those requested changes must be based on changes in the actual costs paid or incurred by AAW/EPCOR with respect to providing the services pursuant to this article.”

In 2010, in Decision No. 72047, the Arizona Corporation Commission (ACC) adopted a wholesale water rate that was effective starting January 1, 2011 for Phoenix of \$0.5102. However, this rate is for wholesale water service and not for water wheeling services. We noted that EPCOR charged \$0.5465 in 2012 and \$0.5828 in 2013 and 2014.

Wastewater

The contract stated that the City would pay AAW/EPCOR for wastewater services at a rate of \$2.32 per one thousand gallons. The contract also stated that “The Parties acknowledge that the rate described....may be altered from time to time by the Commission with or without the consent of AAW/EPCOR. AAW/EPCOR will have the right to request changes in such rate from time to time, but those requested changes must be based on changes in the actual costs paid or incurred by AAW/EPCOR with respect to providing the services pursuant to this article.”

The rates were increased in June 2008 and again in January 2011. In 2011, the City objected and began to pay under protest for two reasons: (1) the contract was what governed rates (instead of the rates approved by the ACC); and (2) the City did not have an opportunity to participate in the 2010 rate setting hearings.

In 2012, in Decision No. 73227 the ACC again changed the rates due to issues that did not involve the City, but were related to a split of AAW/EPCOR's billing areas. For purposes of the ACC's ratemaking, the City was considered a wholesale customer. The wastewater rates applicable to all EPCOR customers were structured in a three-year step down schedule from the rate EPCOR charged all customers at the beginning of its rate case.

See the summary of water wheeling and wastewater rates paid by the City:

Date	Wholesale Water Wheeling	Wastewater
Initial Contract Rates	\$0.3000	\$2.3200
June 2008 (AAW)	\$0.3000	\$3.1700
January 2011	\$0.5102	\$5.5760
January 2012 (EPCOR)	\$0.5465	\$5.5760
January 2013	\$0.5828	\$4.8573
January 2014	\$0.5828	\$4.1387
January 2015	To be determined	\$3.4200

To determine compliance with contract terms, we compared invoiced charges to the rates stated in the contract.

RESULTS

Since June 2008, AAW and EPCOR implemented increases to water wheeling and wastewater services rates without providing support for the higher rates. Water has worked with the Law Department since 2011 to determine if the rate changes were authorized under the contract. This unresolved disputed amount may be up to \$2,730,286.

Based on discussions with Water staff and review of various documents, we determined both AAW and EPCOR charged fees higher than those stated in the contract. The contract stated "AAW/EPCOR will have the right to request changes in such rate from time to time, but those requested changes must be based on changes in the actual costs paid or incurred by AAW/EPCOR with respect to providing the services pursuant to this article." Since 2011, Water (with the assistance of the Law Department) made several attempts to obtain information from AAW and EPCOR to support the rate increases and in April 2011, Water began stamping invoices "Paid Under Protest" on all payments.

Since May 2008, the City paid AAW \$1,428,987 and EPCOR \$1,301,299 above the original terms of the contract. It was likely that AAW and EPCOR have incurred cost increases; however, until EPCOR complies with the contract terms and provides information related to cost increases specific to the contract and new rates are agreed upon, the City will continue to have an unresolved disputed amount of approximately \$357,000 per year for water and wastewater services above the original rates set in the contract.

RECOMMENDATION

- 2.1 Water evaluate the costs of continuing to pay under protest versus the pursuit of other alternatives.

3 – Water Loss

BACKGROUND

Public water systems categorize the amount of water produced into two categories, authorized consumption or water losses. Water loss can be caused by unauthorized consumption, meter inaccuracies, and leakage.

System Input Volume	Authorized Consumption	Billed Authorized Consumption	Billed Metered Consumption	Revenue Water
			Billed Un-metered Consumption	
		Unbilled Authorized Consumption	Unbilled Metered Consumption	
			Unbilled Un-metered Consumption	
	Water Losses	Apparent Losses (Commercial Losses)	Unauthorized Consumption	Non Revenue Water (NRW)
			Customer Meter Inaccuracies and Data Handling Errors	
		Real Losses (Physical Losses)	Leakage in Transmission and Distribution Mains	
			Storage Leaks and Overflows from Water Storage Tanks	
			Service Connections Leaks up to the Meter	

Figure 3-1. Source: EPA Review Draft - Control and Mitigation of Drinking Water Losses in Distribution Systems dated November 20, 2009.

The contract states that "AAW/EPCOR will determine the amount of losses occurring in the treatment and transportation of potable water to the AAW/EPCOR-to-Phoenix delivery point; i.e., meter Z. Unless the parties mutually agree otherwise in writing, the determination will be made in accordance with the percentage of losses reported by AAW/EPCOR to the Arizona Department of Water Resources (ADWR) each year (or, in the absence of such reports, the percentage derived from another reasonable methodology). Notwithstanding the foregoing, the percentage of losses will not exceed ten percent (10%). The losses will increase the amount of potable water deemed to have been delivered and will be accounted for as an additional amount."

We reviewed invoices submitted by AAW and EPCOR to verify the accuracy of the water loss rate billed. We also compared the gallons billed from EPCOR to the gallons billed to City of Phoenix West Anthem customers to evaluate the City's water loss.

RESULTS

Water did not monitor the accuracy of water loss charges to ensure the amounts paid were accurate and in accordance with contract guidelines. As a result,

Water potentially overpaid AAW/EPCOR for water loss charges by as much as \$44,828.

We noted that Water did not monitor the validity of the water loss charges. The contract states that water loss charges will be made in accordance with the percentage of losses reported to the Arizona Department of Water Resources (ADWR) or other reasonable methodology approved in writing and the percentage of losses will not exceed ten percent (10%). During our review, we noted that AAW and EPCOR charged the maximum rate of 10% without support for water losses related to the wheeling service or approval from Water.

During the course of the audit Water staff contacted EPCOR to determine how the water loss amounts were calculated. EPCOR stated that they reported distribution system water loss percentages to the Arizona Corporation Commission (ACC), not ADWR; that they had charged 10% instead of the percentages reported to the ACC and they would issue a refund of approximately \$6,926.

Based on EPCOR's revised methodology, we performed a calculation using the water loss percentages reported to the ACC (1.8% for AAW and up to 7.36% for EPCOR) and the gallons on the monthly invoices. Based on our calculations, EPCOR overcharged Water by \$6,947 and AAW overcharged Water by \$19,355. However, as Water did not approve the alternate methodology possible water loss overpayment could be as high as \$44,828.

Although Water did not have a formal water loss control program for the West Anthem service area, Water made changes to reduce authorized and unauthorized non-revenue consumption after they incurred significant cost increases. West Anthem area water loss of 6.5% was below ADWR's allowable standard of 10%.

The City paid approximately \$150,000 per year in charges for non-revenue water and wastewater services in the West Anthem area. As noted in the chart above, non-revenue consumption falls into two categories; authorized and unauthorized. The West Anthem water system is a dead-end; i.e., water does not flow through the system. Therefore, system flushing was required to maintain water quality and considered authorized non-revenue consumption. According to Water staff, water losses related to unauthorized consumption, customer meter inaccuracies, and leakage.

ADWR's water loss standard is 10% for large water agencies. The 2013 Citywide water loss rate was 8.19%. However, due to the high cost of water and wastewater services in the West Anthem area, it was important that Water ensured water loss was minimized. Water staff stated that due to limited resources, water losses were not actively monitored.

From 2010 to 2011, water and wastewater costs increased significantly, from \$864,000 to \$1,537,000 (44%). To reduce non-revenue consumption, Water made changes to its flushing practices and during the spring of 2012, Water crews surveyed and repaired leaks in the West Anthem area. Based on data obtained from Water, authorized consumption was reduced from 6% to 5% and unauthorized consumption was reduced from 6.9% to 6.5% of the system input (gallons wheeled by EPCOR).

In addition, the Environmental Protection Agency (EPA) recommends public water systems develop water loss control programs to help locate and reduce water losses. The program should include water audits, intervention, and evaluation. Although Water repaired leaks in 2012, as stated above, Water currently does not have a formal water loss control program or perform ongoing monitoring of non-revenue consumption, authorized or unauthorized.

RECOMMENDATIONS

- 3.1 Water and EPCOR establish, in writing, a reasonable methodology to calculate water losses related to the wheeling service and assign staff to monitor the accuracy of water loss charges. Water work with Law to determine if the overpayment to AAW can be recovered and collect the monies from EPCOR related to water loss overpayments.
- 3.2 Water develop a formal water control program and assign responsible staff to track/monitor water losses and methods to reduce non-revenue consumption.

4 – Taxes

BACKGROUND

The City is exempt from paying taxes on wholesale water purchased for resale by City Code section 14-480(c) and Arizona Revised Statutes 42-5061 (I)(2) and 42-5063 (B)(1).

City Code section 14-480 (c) states: *customers or ratepayers shall be exempt and deductible from the gross income subject to the tax imposed by this section, provided that the purchaser is properly licensed by all applicable taxing jurisdictions to engage or continue in the business of providing utility services, and further provided that the seller maintains proper documentation, in a manner similar to that for sales for resale, of such transactions.*

Additionally, we reviewed Arizona Revised Statutes 42-5061 (I)(2) and 42-5063 (B)(1) and noted: *The tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from: 2. Utilities classification. Utilities were defined as Producing and furnishing or furnishing to consumers natural or artificial gas and water.*

We reviewed Arizona American Water (AAW) and EPCOR invoices from January 2008 through December 2013 to determine if taxes were appropriately not charged in compliance with City Code 14-480(c) and Arizona Revised Statutes 42-5061 (I)(2) and 42-5063 (B)(1).

RESULTS

Water did not monitor payment made for taxes. Although the City was exempt from taxes on wholesale water purchases under City Code and Arizona Revised Statutes, Water paid over \$5,377 for taxes.

In 2006, CAD recommended Water provide tax exempt information to AAW, EPCOR's predecessor, and recover \$24,000 in erroneously paid taxes. We reviewed AAW invoices and noted for a period of time AAW stopped charging taxes, however, in May 2008, AAW began charging taxes again until AAW was sold to EPCOR in January 2012. Between May 2008 through January 2012, Water inappropriately paid AAW over \$4,163 in taxes.

When EPCOR took over in January 2012, they continued to charge the City for taxes through February 2013. Based on review of the invoices, it appears Water informed EPCOR that the City is exempt from paying taxes and EPCOR issued a credit of \$250. However, Water paid an additional \$1,214 in taxes that was not recovered.

In addition, Water could not provide support that the \$24,000 was recovered from AAW nor could they provide an explanation for why taxes were continued to be paid.

RECOMMENDATION

- 4.1 Water work with Law to determine if the overpayment to AAW can be recovered and with Law's assistance recover \$1,214 from EPCOR for inappropriate State and County taxes paid.

5 – Cost Savings Opportunity

BACKGROUND

Wastewater

The contract states "The initial wholesale wastewater rate will be \$2.32 per one thousand gallons of potable water delivered by TreatCo to Phoenix. If and when the potable water service is discontinued, the rate pursuant to this section will be converted to a metered rate."

We calculated potential wastewater costs savings using an estimated metered rate instead of per one thousand gallon of water consumption.

RESULTS

Based on internal reports prepared by Water, we estimated the City may realize \$270,000 of annual savings by building infrastructure to deliver potable water to West Anthem and paying for wastewater through a metered rate. A cost of service study will be required to determine the actual value of the potential savings.

Although the contract allowed for using a metered rate, as the City had not terminated the potable water service (wheeling) section of the contract, the City paid wastewater services based on 100% of the water consumption. To estimate the potential impact or lost savings caused by not using a metered rate, we obtained Water's residential wastewater rate (65% of water consumption) and billed water consumption from May 2008 through December 2013. Based on our analysis, we estimated the City could have saved up to \$2.5 million if wastewater charges had been metered. Further, based on the ACC approved wastewater rates for 2014 and 2015, the City will pay approximately \$540,000 above the estimated metered charge.

We also reviewed several internal reports prepared by Water, including a 2010 report which recommended Water build the infrastructure needed to discontinue potable water service, which would then require wastewater services be metered. A 2013 report stated it would cost approximately \$2.7 million to connect the West Anthem area to the City's water system. We did not review the accuracy of the wastewater percentage or the capital costs of infrastructure in these reports. However, we noted that the cost savings from 2008 through 2013 (\$2.5 million) would have paid for most of the infrastructure costs (\$2.7 million) necessary for metered wastewater. The City would also achieve additional cost savings related to the reduction of water treatment and the elimination of water distribution and wheeling costs.

RECOMMENDATION

- 5.1 Water review the infrastructure costs to connect West Anthem to the City's water system and analyze the costs and benefits of this capital project compared to other proposed projects.